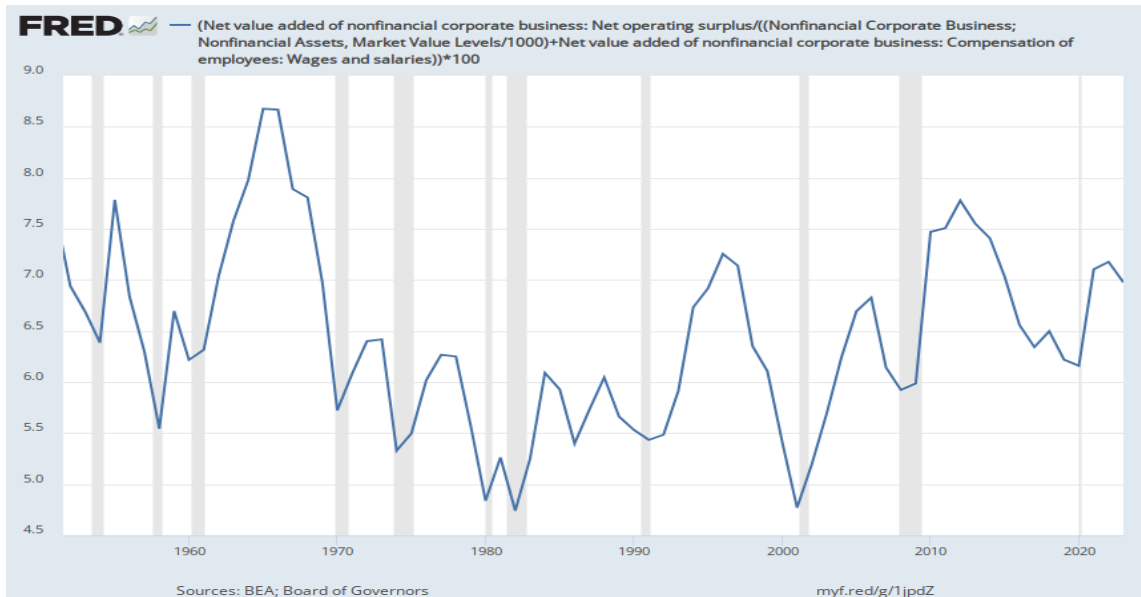


THE FED'S USE OF 'MARKET VALUES' TO CALCULATE THE RATE OF PROFIT IN THE USA. Dr. JEFFRIES SHOULD DIRECT HIS CRITICISM TO THE FED.

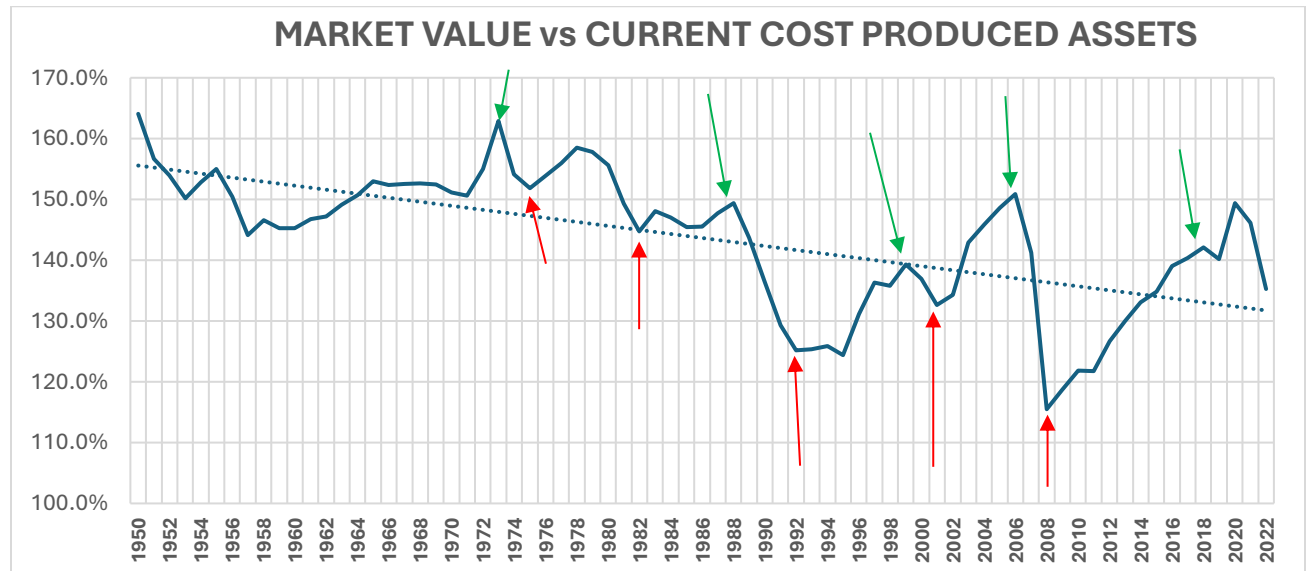
Michael Roberts was provided with [this link](#) to the FED's estimation of the rate of profit. This provided the following graph prepared by the FED. It is known that the FED and the BEA have been producing rates of profit and rates of return for some time. What is not known is how much this influences FED decisions.

Graph 1.



This graph is controversial for two reasons. Firstly it uses market value to estimate the value of nonfinancial assets. These assets include inventories which are also estimated at market value or by selling price rather than cost-price. The link to this valuation and items listed under nonfinancial assets can be [found here](#).

Graph 2.



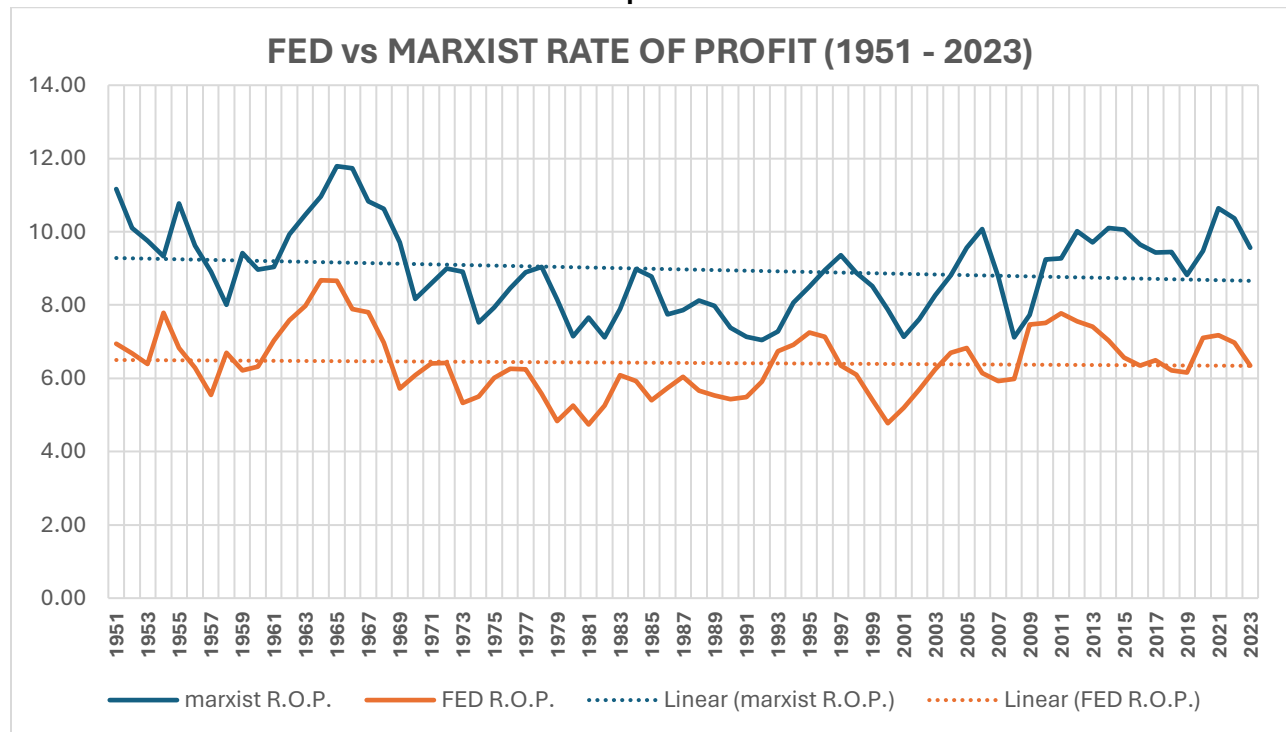
Turning to the graph above, we note that up to 1990 the market value of nonfinancial assets exceeded that of fixed assets at current cost by about 50%. Up to 14% of that 50% was accounted for by the valuation of inventories which the FED includes under the heading non-financial assets. This still leaves a gap of a third. After 1990 following the restructuring of the US economy, globalisation, and increased speculation there was more volatility in valuations, but interestingly enough, it also led to a lower spread between assets valued at cost or valued by the market.

However, the most important takeaway is that the divergences and convergences describe the business cycle. In the upphase of the cycle, the rise in the market value of assets creates a peak, and in the downphase of the business cycle it forms a valley. Follow the arrows. The green arrows highlight the end of the up cycle and the red arrows the end of the recessionary or down cycle which tends to be shorter.

What is causing this significant appreciation or depreciation of assets when measured by market value. For example between 2006 and 2009 the market value of assets fell by almost 40%. The answer is these assets are being valued fictitiously, not by what they cost to produce, but by the discounted cash flow they can command. During the upturn when discounted cash flows rise due to rising profits, it rebounds back onto the asset enhancing its valuation. Let us say an expected cash flow of 5% yields an asset value of \$1. If that yield goes up to 10% the asset value will be bid up to \$2. But if that yield falls to 3% then that asset will be marked down to \$0.60. Of course this is the simple example.

The **market value** of assets is therefore a **function** of the **income stream** it can **command**. It has nothing to do with the actual cost of producing that asset. The BEA in its Fixed Asset Tables and elsewhere lists assets at their current cost of production. This includes inventories which are valued at their cost price. On average the cost price of assets tends to be lower than their market value which is influenced by demand and supply, more money than brains, and more by opportunism than acumen.

Graph 3.



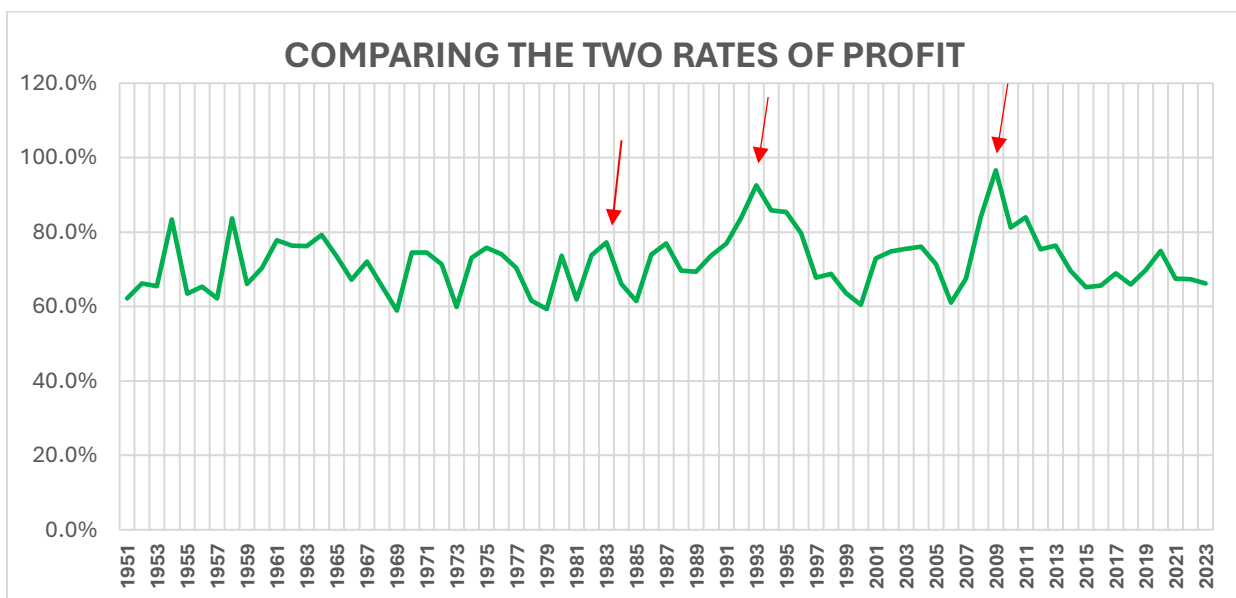
The first thing to note is that if the valuation of capital differs, then the same amount of profit or surplus will yield differing rates of profit. This can be seen in the graph above. The Marxist rate of profit is higher than the FED rate of profit despite the fact that the market value of the assets exceeds their produced value. The reason for this is not hard to find. The FED's denominator for capital uses fixed assets plus annual wages. But **annual** wages is not the same thing as variable capital. The capitalists do not need to hold money for 365 to pay wages. In reality, and on balance, they just need to keep about 90 days worth of wages, because 90 days is the period between money going out to purchase the factors of production and money coming back in from sales revenue. In other words the average circulation period of working capital is about 90 days because capital tends to turn over on average 4 times a year ($365/4=90$).

There is another interesting observation to consider. Note how the FED rate of profit peaks a year ahead of the Marxist rate of profit. This is due to valuations (market) spiking right at the end of the up-cycle in what is known as the overheating phase. This is when valuations are at their most extreme or frothy. This raises the market value of capital which in turn depresses the rate of profit at this time.

We could use this observation to predict the end of the up-cycle in advance. In other words comparing the premature fall in the rate measured by market value to that measured by its cost of production. The same applies to the downside, the rate of profit measured by market value precedes the rise in the rate of profit measured by produced assets. This is because the revaluation of assets by income stream is a delayed event. Before assets can be marked higher the income stream has to rise significantly, and because market value is subjective, not only must the income stream be seen to be rising, but investors need to be confident that it will continue to rise. Until then the market value of assets will remain depressed thus any increase in profits will tend to boost the rate of profit when measured by market value.

The final point to make is that the long-term tendency for the rate of profit to fall when measured by market value is misleading. The fall in the rate can only be seen when we use the Marxist rate of profit. (The blue trend in Graph 3). Moreover, the trend would have fallen close to 8% by 2023 were it not for the recent artificial boost to the net surplus from Covid subsidies and profit gouging such funds made possible.

Graph 4.



The key question is this, which rate is the dominant one influencing investment decisions; the market rate of profit or the actual rate of profit? The answer is the latter. When the Chief Executive Officer and his or her board decide to make an investment, they instruct their cost accountants to calculate the cost of the intended investment. That calculation will be based on the cost of purchasing the needed equipment and machinery, the construction costs, the expected amount of raw and auxiliary materials to be stocked, and how much working capital will be needed until the cash flow becomes positive. This is an involved calculation which has nothing to do with market value unless the Chief Executive Officer intends to buy some of the factors of production second hand, which is the exception rather than the rule, except if these assets are being sold off at distressed prices.

Dr Jefferies, the proof is here.

Dr Jefferies has criticized us Marxists for using the produced asset valuations as found in the BEA Fixed Asset Tables. He has done so despite the BEA making it clear these assets are produced assets which are being valued at their current cost of production. The current cost of production is calculated on the basis of the opening value of these assets on January 1st, plus gross fixed investment during the year minus depreciation during the year yielding a closing value on December the 31st which in turn is then adjusted for price movements during the year (actually the depreciation of money). So no hint of market value.

These assets are not being marked up or down based on income streams hence by mark to market. Dr Jefferies has accused us of under-estimating the rate of profit because he assumes that the assets we use are overvalued because they are the reflexive product of future income streams. But as we have seen, we are not guilty. The cost of the assets we use are much lower than their market value. This much is made quite clear in Graph 3. And if they are lower then how can we be producing depressed rates of profit?

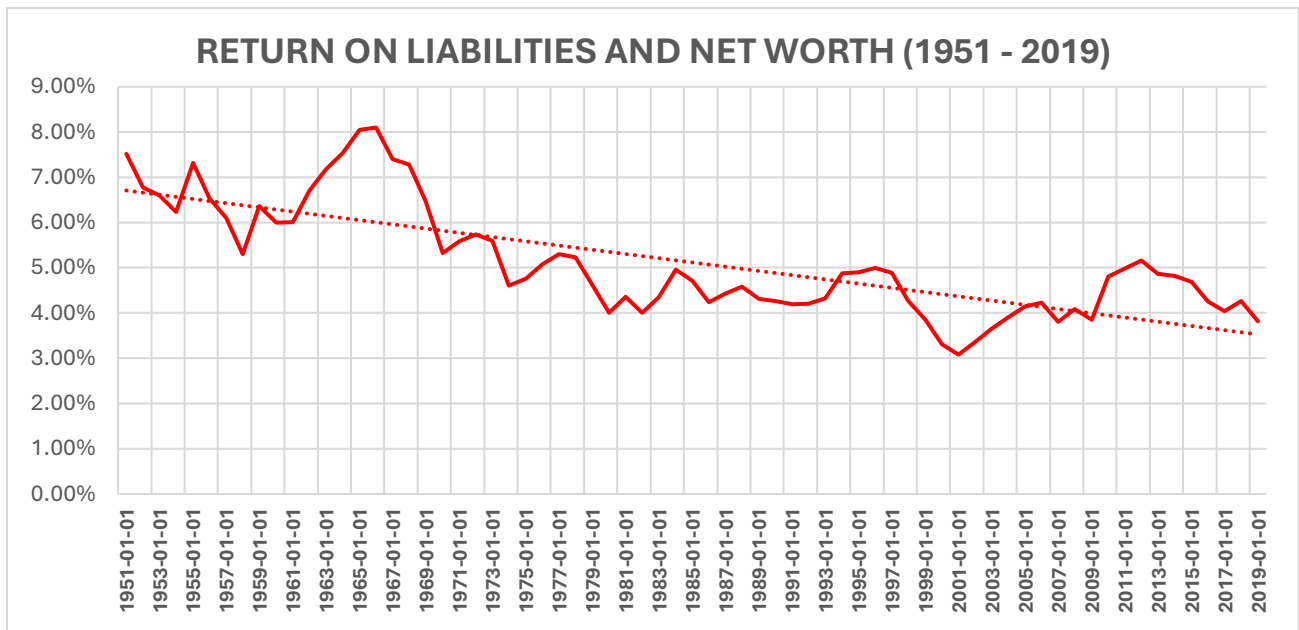
Our rate of profit is higher than the FED's, but his rate of profit is even higher, what I call his rate of frothit, aka the tendency for the rate of profit to rise, not fall. In one swoop he has upended the most important law governing the future of capitalism. Using *Occam's Razor* the simplest explanation is that he has made an error. And indeed he has, because he has plucked the wrong figure from the IRS Tables to use for his fixed asset valuation. He has ended up deducting depreciation twice resulting in an abnormally low valuation of fixed capital. However, it is more likely the sun will go cold before he will admit to his error.

Jefferies is not the only faux Marxist. It appears the FED has graciously allowed access to a number of so called Marxists to populate its website with graphs depicting 'Marxist rates of Profit' and even the 'Rate of Surplus Value'. Each and every one omits turnover or the circulation of capital, thus they follow the FED in using annual wages as their denominator when calculating the rate of profit or surplus value. This of course yields a rate far removed from the actual rate of profit, or to use the data in Graph 3 & 4, a rate which is adrift by 30-40%. To examine these graphs please follow [this link](#).

Conclusion.

I posed the question earlier as to whether the FED took the rate of profit seriously and whether it informed their decision making. If it does then the following graph will be the influential one. It is net surplus divided by liabilities plus net worth. (Note 1.) Why this denominator? Because this is the one used by corporations themselves to calculate their rate of return. It seems confusing until one realizes we are dealing with T accounts, so liabilities plus net worth on one side of the T equals total assets on the other side of the T. Therefore, the formula used is actually the surplus divided by total financial and non-financial assets.

Graph 5.



I have cut the graph off in 2019 so as to avoid the confusion generated by Covid funds during the Pandemic. Here the fall in profitability is much sharper because of the increase in non-financial assets. In effect the rate of return has halved.

The array of non-financial assets can be found once again on [this link](#). In Table S.5.q the balance between financial and produced assets is now roughly fifty - fifty. By 2019 the rate of return had fallen to levels not seen since the height of the financial crisis. I am of the opinion that the FED took this collapse in profitability to be a key factor for repressing interest rates because the rate of interest is contingent on the rate of return with lower rates of return only able to commensurably support lower rates of interest.

The rate of profit is the pulse of capitalism. When this pulse weakens the whole body ails. It therefore needs to be measured precisely if the health of the patient is to be assessed accurately. Marx provided us with such a pulsometer, so why not use it as intended. The only precise rate of profit is;

profits over constant and variable capital or profits over fixed and circulating capital.

Any other ratio has nothing to do with Marx.

(Note 1. In all cases the net surplus is the one used by the FED derived by subtracting compensation plus production taxes from net value added.)

Brian Green, 2nd April 2024.